Portugal:
Macroeconomic and financial outlook

BPI *Research*

March 2022

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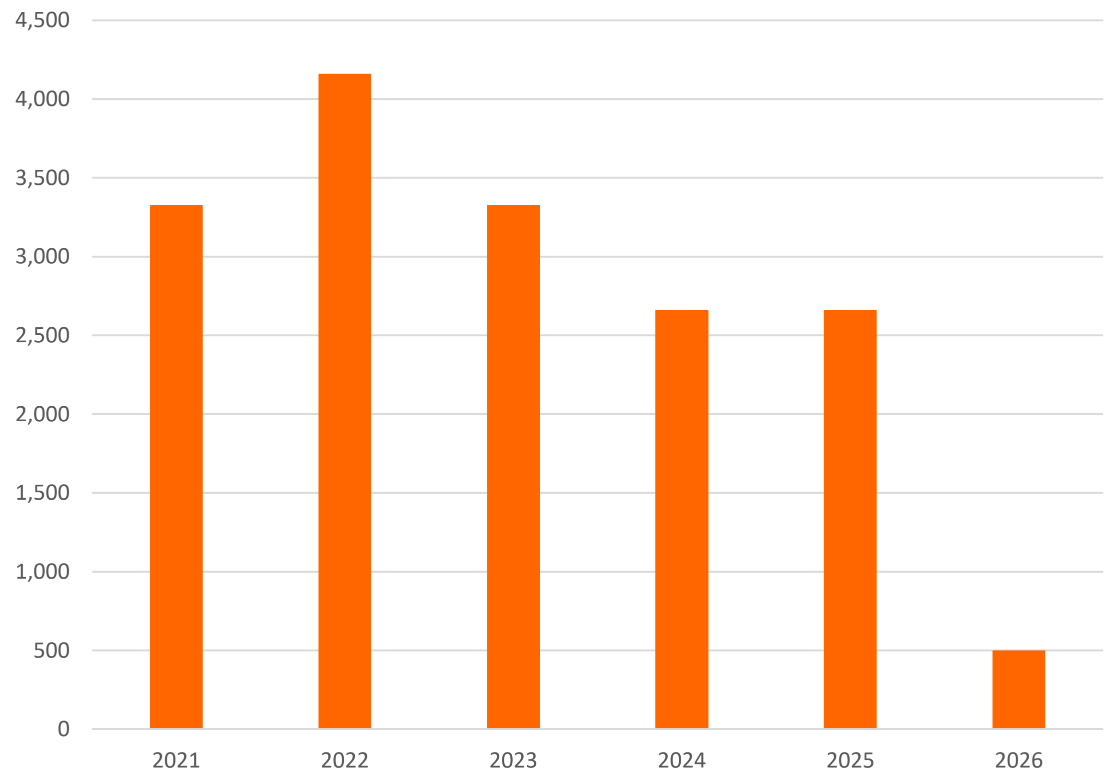
BPI Grupo CaixaBank

Main messages

Activity	▶ **GDP grew 4,9% in 2021, better than expected.** GDP increased 1,6% qoq and 5,8% yoy in Q4, reducing the gap for the pre-covid level to -1,4%. Domestic demand add 5,2 p.p. to growth, with consumption and GFCF growing 4,4% and 6,1%, respectively. ▶ **Our current scenario foresees economy to advance 4,9% in 2022, which taking into account the carrying over effect from strong growth in Q4 2021 and the very conservative qoq forecast for growth in Q1 2022, and accommodates a possible slowdown of activity in the wake of the current situation in Ukraine.** Even so, the degree of uncertainty related with the war Russia-Ukraine is very high and risks clearly biased on the downside, either due to the increase in energy prices, or due to the foreseeable slowdown in activity in important trading partners, namely the central European countries. We estimate that an increase of 10$ per barrel annual average increase of oil prices and a 20€/MWh increase in gas prices will reduce GDP growth by 0,8pp. ▶ **Inflation is accelerating:** headline inflation rose to 4,2% in February, driven by higher energy prices and its spread to other componentes. In the current scenario of war Russia-Ukraine, this upward movement may be stronger and the deceleration expected in the H2 may be smoother than previously expected. An upward revision of our current forecast (2,2% in 2022) is very probable.
Banking sector	▶ **Despite the end of moratoria last September, the Portuguese banking system maintains a strong financial position**. NPLs continue to decline and banks built reserves to face future losses, with NPL coverage ratios at ≈55%. Liquidity and solvency ratios continue also to improve. Healthy balance sheets will be key to accommodate a possible increase in bad loans due to the end of moratoria and also due to maturity of credit lines from mid-2022. Moreover, the possibility of restructuring debt under moratoria, with state guarantee, a measure aimed at the most vulnerable sectors, will probably reduce the impact.
Policy	▶ **The majority obtained by the Socialist Party will facilitate the approval of the State Budget proposal for 2022, that probably will not differ much from the main measures announced in the last proposal rejected in November 2021.** General elections results will also ease the approval of reforms and measures needed to receive NGEU funds. Main risk is related to the scarcity of resources and the increasing costs. ▶ **The Government adopt a set of measures to limit the impact of higher energy prices due to the war in Ukraine:** from these we highlight: €20 refund for refueling (autovaucher) in March; suspension of the increase of the carbon tax up to the end of June; refund of the impact that the petroleum product tax has on VAT due to the increase of fuel prices up to the end of June. ▶ **Despite the strong support to the economy, the fiscal deficit and public debt are declining.** In 2021, fiscal deficit stood at 4,2% of GDP – cash basis - (5,7% in 2020) and public debt declined to 127,5%, -7,7 p.p. than in 2020. This positive trend is expected to remain unchanged, but public accounts may face several challenges in the near future (possible execution of guarantees related to Covid-credit lines, eventual additional financing needs of some SOE and the impact of new measures to contain the impact of increasing energy costs). Nevertheless, there is room to accommodate potential fiscal slippage as the economy is showing strong dynamics and as public debt increased comparatively less in 2020 than in other European peers. ▶ **The Government public funding needs will be less covered by ECB purchases in 2022 than in 2020-21, but ECB acquisitions will continue to be an important support, (expected to cover around 40% in 2022). Still, the Treasury liquidity cushion amounts to circa €19 bln (≈9% of GDP).**

The Recovery and Resilience Plan: a key element for recovery

Time distribution of NGEU transfers
(million of euros)



Source: *BPI Research, based on Government figures.*

Approvals and Payments to Direct and Final Beneficiaries
(million of euros)

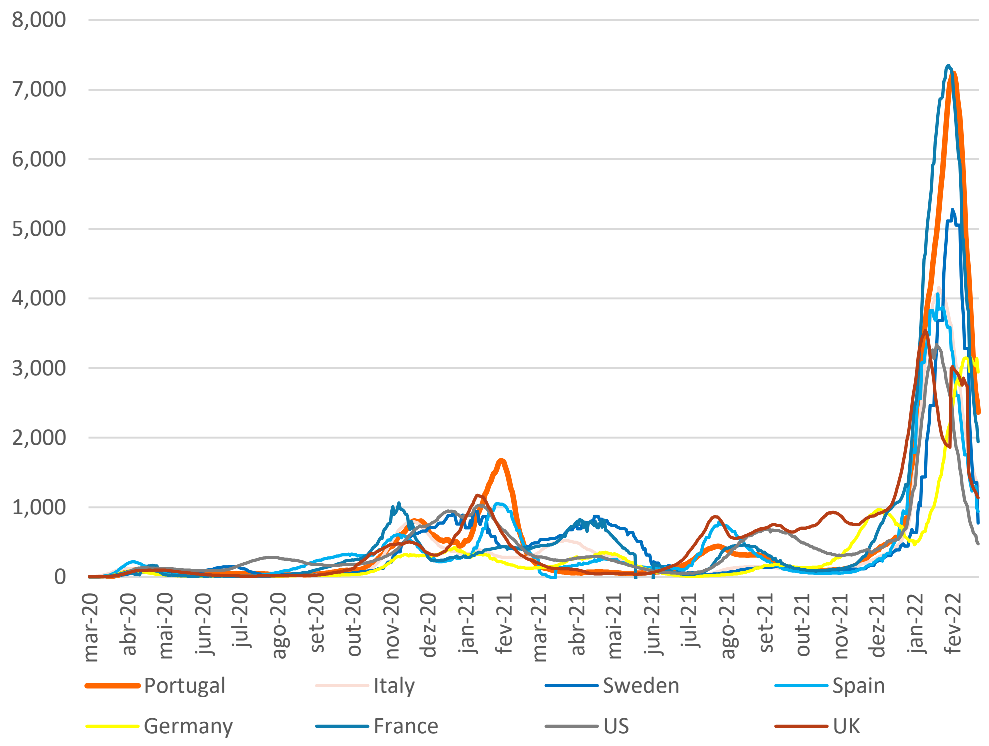
Up to February 23rd	Amount approved	Amount payed
Families	30	25
Solidarity and Social Economy Institutions	1	0
Non-financial corps.	0	0
Institutions of the scientific and technological system	0	0
Higher education institutions	252	22
Schools	228	30
Municipalities and metropolitan areas	288	32
Public entities	1.768	153
Public enterprises	1.627	155
Total	4.194 (25,2% of 16,4 MM)	418 (2,5% of 16,4 MM)

Source: *BPI Research, based on Government figures.*

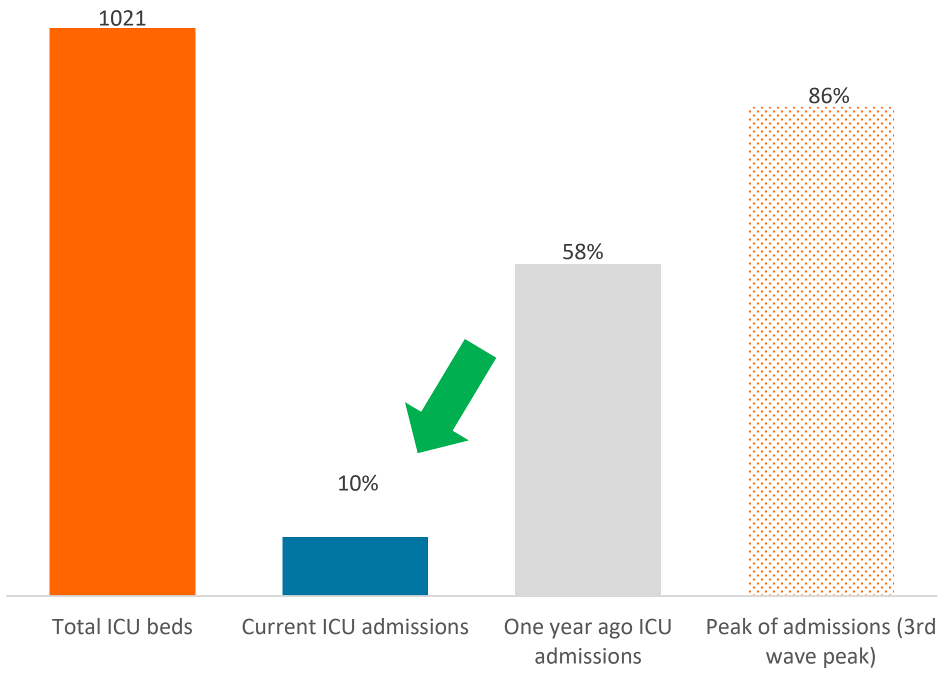
- **Portugal will receive €13,9 bn (≈6.5% of 2019 GDP) between 2021 and 2026** as subventions (+€2,7 bl as loans) from the European Recovery and Resilience Mechanism. **Portugal has already received the pre-financing amount: ≈€2,2 bln. Recently, the country requested the first payment at the beginning of 2022 (€1.162m).**
- **Macro impact:** We anticipate an execution rate of ~50% in 2021, with a growth contribution of ~0.2 p.p..In 2022, the impact on growth will be ≈0.6 p.p.. Between 2021-26, funds will probably add to Portugal's annual GDP between 0.8 and 1.5 p.p., on average.
- **Main risk:** the main risk is probably related to the scarcity of resources to go ahead with investments (for example, shortage of labour force in some sectors) and the increasing costs.

Wave of contagions with Omicron declined considerably

COVID-19 cumulative incidence
Infections per 100k inhabitants accumulated in 14-day



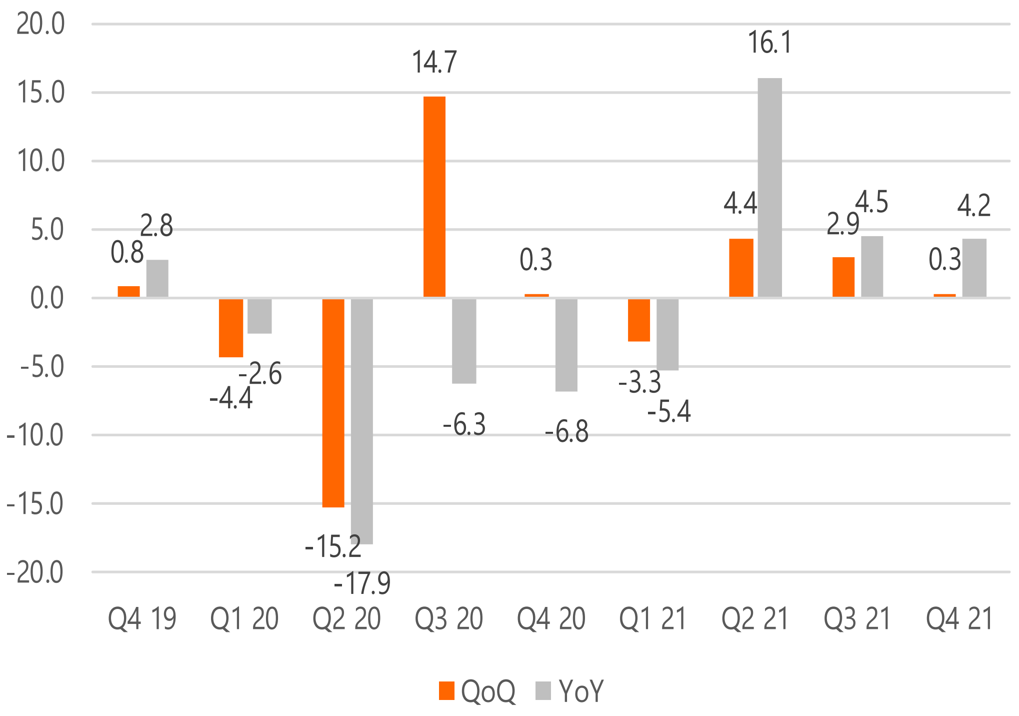
UCI admissions vs. UCI installed capacity
Unit, %



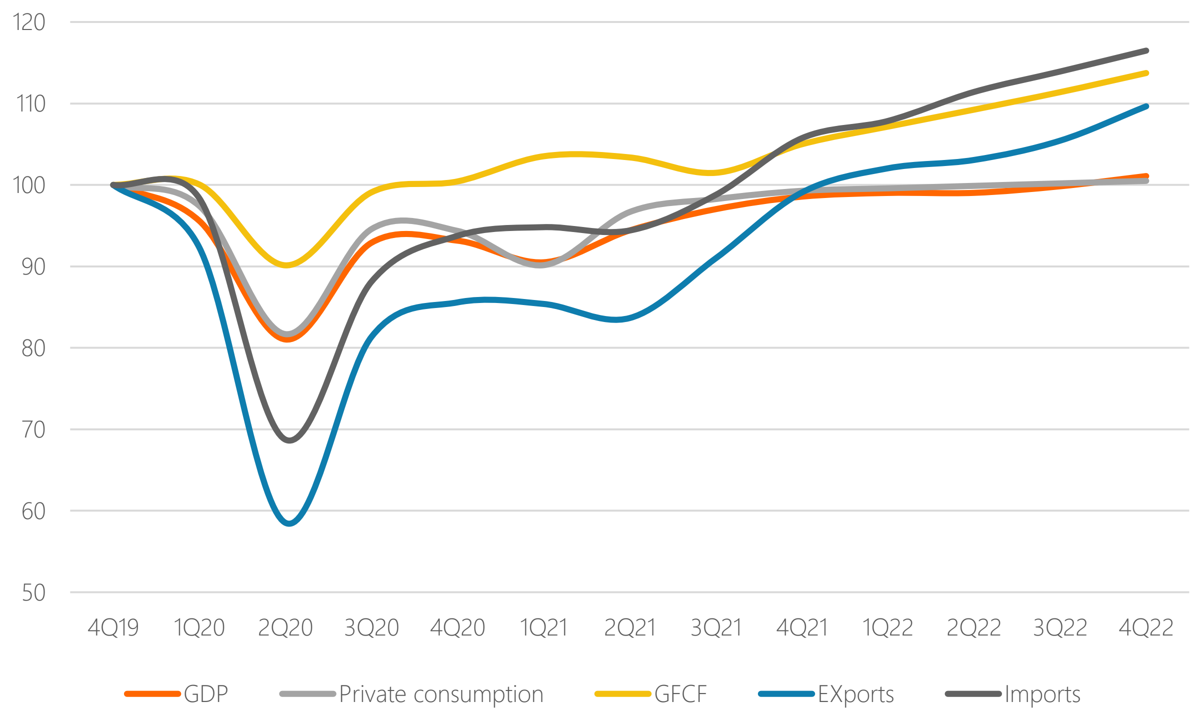
- **14-day cumulative incidence reached the peak in the end of January, but since then is declining on a strong pace, but remains well above the threshold of 120 cases per 100k set by the Government (≈7.000/100k). The high rate of vaccination continues to avoid the increase of serious cases**, allowing to keep UCI occupation low, circa 10% of levels seen one year ago. Hospitalizations and mortality continue contained and well below the levels registered at the beginning of 2021.
- In the current scenario of less severe effect related with infections, restrictions imposed in the end of 2021 are being lifted, which will allow the return to normality of the economic activity.

Growth in Q4 surprised on the upside and push annual growth to near 5%

GDP growth
Percentage change (%)

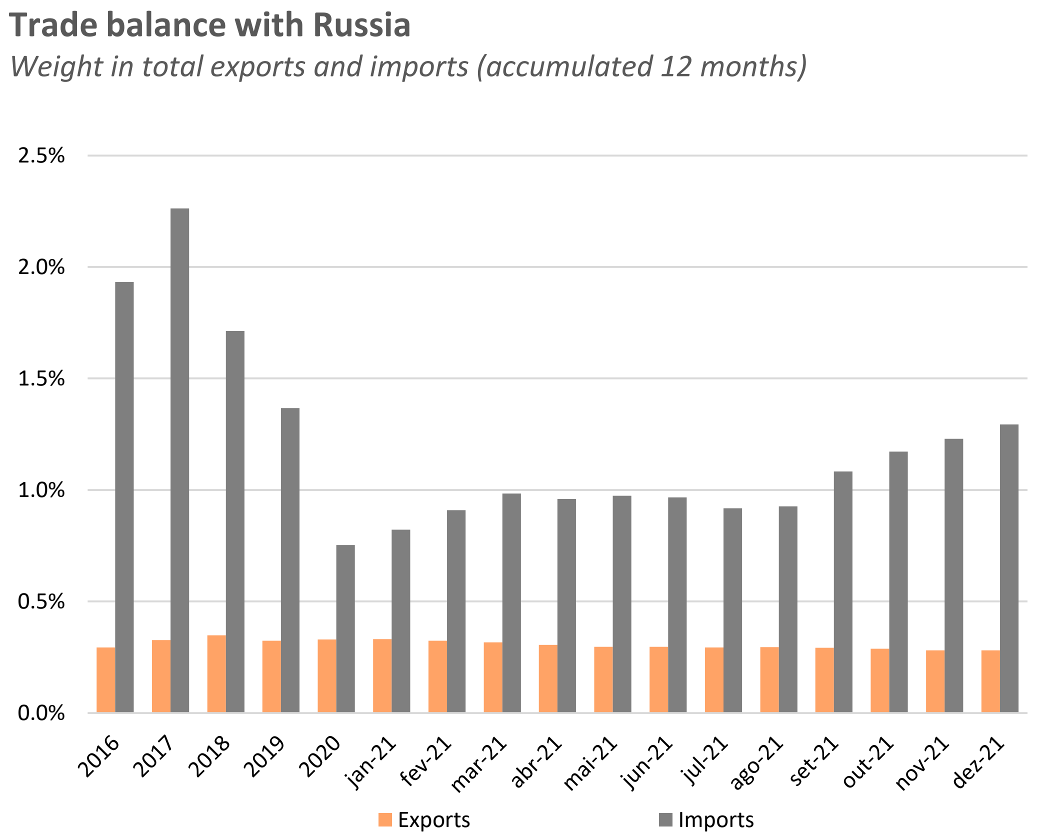


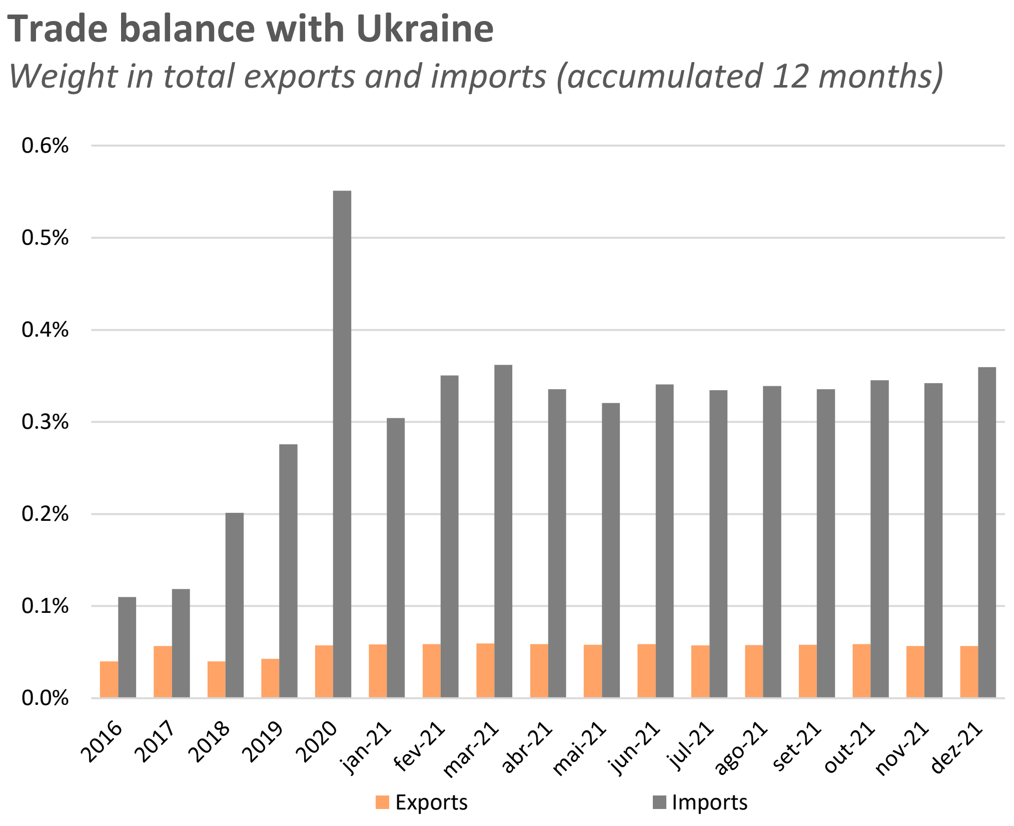
GDP: recovering trend
Q4 2019 = 100



- **GDP posted an annual growth of 4,9% in 2021, taking advantage of a better than expected performance in Q4: 1,6% qoq and 5,8% yoy, supported by the positive performance of domestic demand and exports. The gap for 2019 narrow to 3,9%.**
- **Central scenario**: our main scenario sees GDP advancing around 5% this year and reaching the pre-covid level by the end of the first semester. Despite the strong carrying over effect from 2021 (if qoq growth were 0,0% in all quarters of 2022, GDP will advance 3,7%), the beginning of the war in Ukraine introduced a very high degree of uncertainty, with risks skewed in the negative direction, either due to the increase in energy and food prices in the international markets, or due to the foreseeable slowdown in activity in important trading partners, namely the central European countries.

Reduced direct exposure to Russia and Ukraine





- Portugal's direct exposure to Russia (0.3% of exports) or Ukraine (<0.1%) is of little relevance**, so the expected effects on the Portuguese economy will essentially be indirectly.**
- **The most obvious indirect effect will be through the increase in energy costs:** we estimate that an increase of 10$ per barrel annual average increase of oil prices and a 20€/MWh increase in gas prices will reduce GDP growth by 0,8pp.

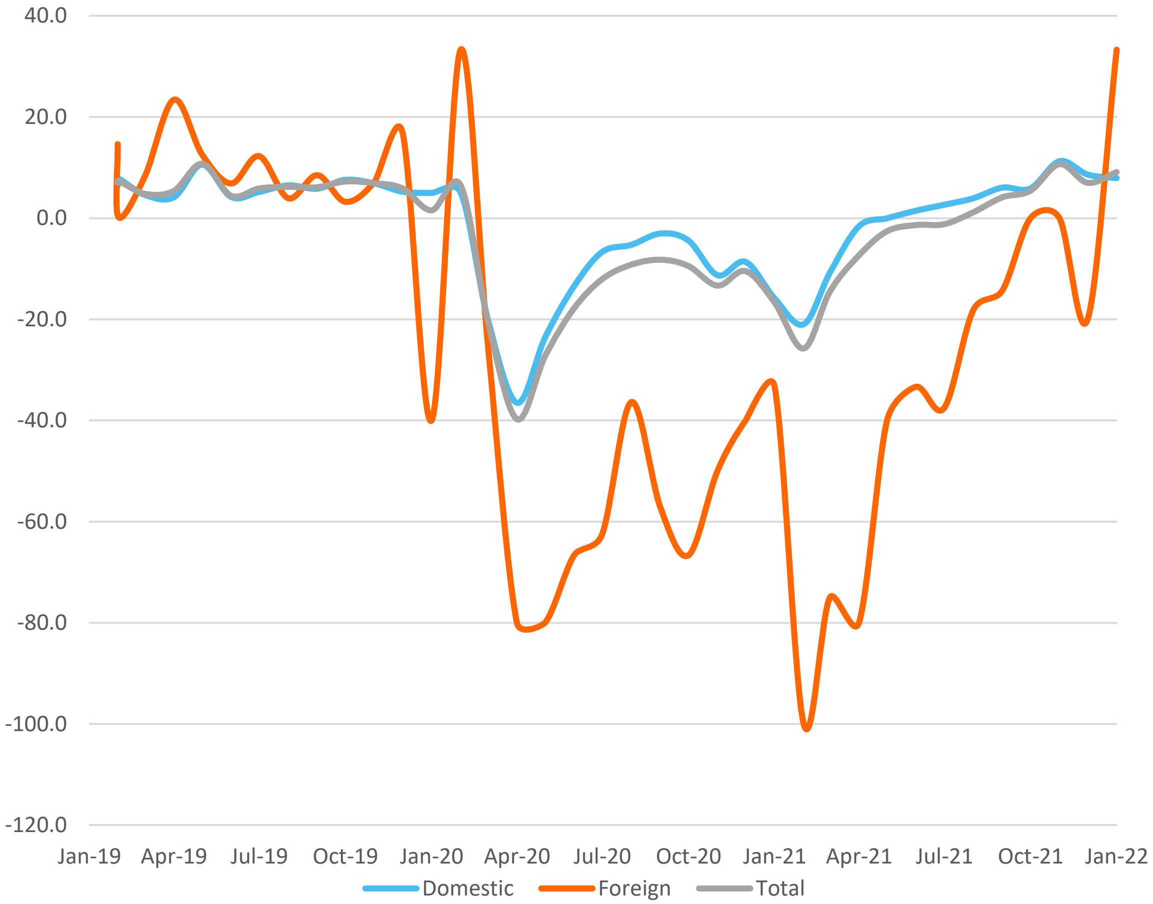
Consumption supports growth in the beginning of 2022

Consumer confidence indicator: important purchases in the next 12 months

Points

Cards activity

Year-on-year (%)



- **Consumption continues to perform well**: households are confident and expenses paid with electronic cards in January surpassed by 9% the level of January 2021.
- **Non-residentes expenses in January grew more than 30%** in comparison to the same month of 2021, reflecting the sentiment that current variants of the Covid-19 are less severe and anticipating a sustained recovery in tourism.

Activity monitor – consumption and exports well anchored above pre-covid levels

Year-on-year change (%)	Daily Economic activity indicator	Credit cards	Cement	New registrations of passenger cars	Electricity consumption	Industrial production	Retail sales	Number of tourists	Exports of goods (ytd)	Imports of goods (ytd)
2019	-	6.5	15.1	-2.0	-0.1	-2.3	4.3	7.9	3.5	6.0
2020	-8.9	-13.5	10.9	-35.0	-3.0	-7.0	-3.3	-61.6	-10.3	-14.8
2021	-2.9	-2.2	17.0	-34.4	-2.1	-4.2	0.7	-46.4	3.9	-2.2
Q1 2021	-4.2	-12.8	10.2	-31.5	-1.7	-4.5	-8.9	-78.7	-10.3	-17.6
Q2 2021	-2.0	-3.8	21.9	157.6	-3.6	-5.8	1.9	-64.5	3.8	-6.1
Q3 2021	-1.1	1.4	15.3	-23.8	-1.3	-5.4	1.8	-31.6	2.9	-4.3
Q4 2021	-1.9	7.7	16.2	-14.2	-2.1	-3.6	4.8	-20.2	5.1	1.2
October	-2.9	5.4	0.6	-32.4	-3.3	-5.0	4.0	-14.8	4.2	-0.6
November	-1.5	10.7	27.8	-33.4	-1.2	-2.0	5.8	-17.0	5.3	1.2
December	-1.3	7.0	20.4	-28.9	-1.9	-3.7	4.6	-28.9	6.0	3.2
January	-7.5	9.1	10.8	-31.9	-4.2	-9.1	-0.5			
February	-0.4									

Note: After March 2021 (inclusive), the comparisons are made with the respective month in 2019. January 2022 with January 2020

Rate >= avg. prev. quarter

Rate < avg. prev. quarter

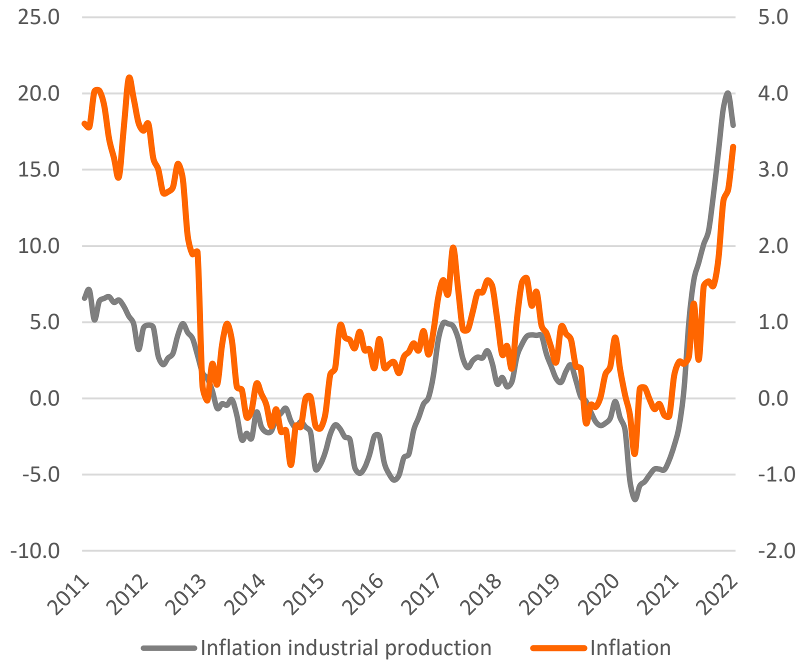
Inflation continues to accelerate at the beginning of 2022

Inflation January 2022 by components

Source: *BPI Research, from INE.*

Inflation in industrial production and overall inflation rate

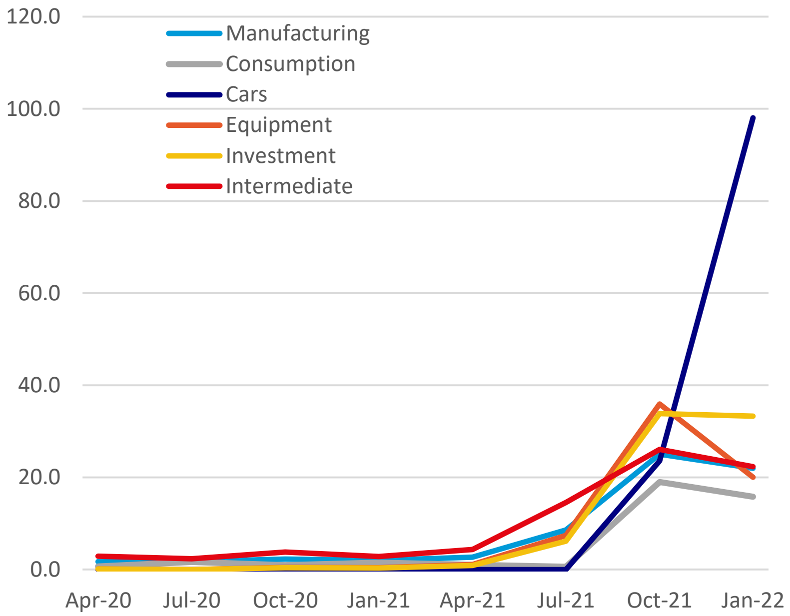
Year-on-year (%)



Source: *BPI Research, from INE.*

Obstacles to production in Portugal

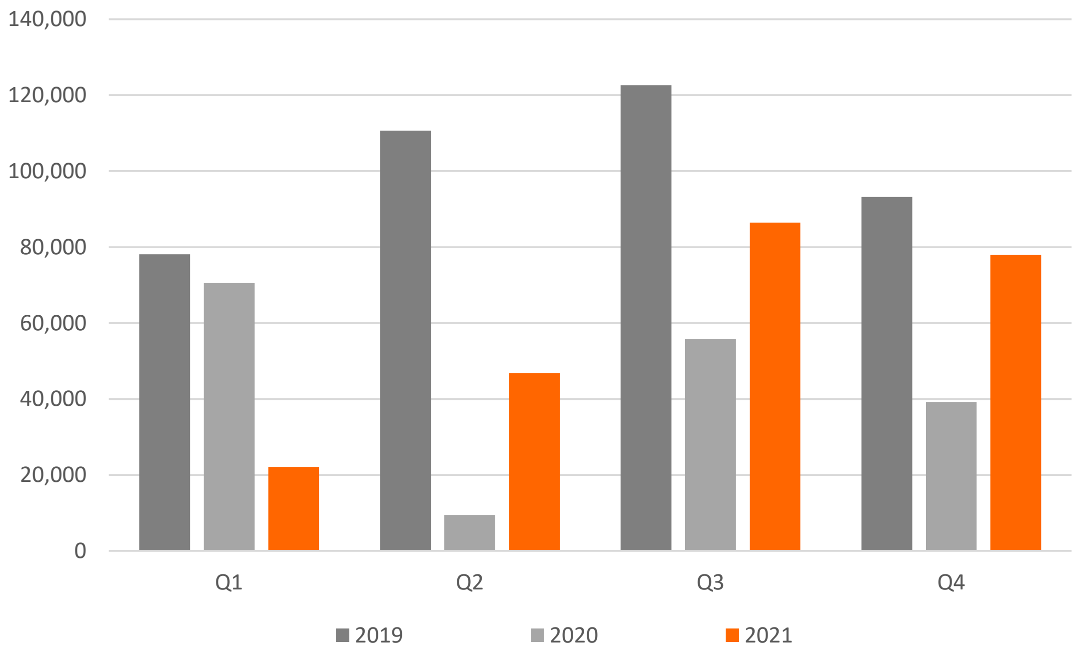
Report of insufficiency of materials in the manufacturing industry (%)



- **Inflation accelerated in February** to 4,2% (3,3% in Jan.), driven by higher prices on energy component (detail still not available). Additionally, high energy prices have started to spread to other components (food for example), driven by the impact of scarcity of inputs in a period of higher demand. Core inflation accelerated to 3,2%, from 2,4% in January. **Inflation should remain high in the first half of the year and moderate in the second half**: drop in energy prices and supply bottlenecks should ease during the last part of the year. However, in the current scenario, there is more uncertainty regarding the pace as prices will moderate.
- **Portuguese inflation is lower than the European one in almost all the items considered in the CPI basket**. This difference is more apparent in classes related to energy – fuels, gas, electricity – and to activities within the Tourism sector – namely Restaurants and Hotels. The behavior of this last sub-group reflects the higher weight of tourism in the Portuguese economy, sector whose activity is still far below pre-covid levels. As for energy prices, the smoother behavior is related to some internal price-setting mechanisms, which accommodate greater price volatility in the international markets. This is the case of electricity prices, given the price setting components and the frequency of updating by the regulator (only once a year in Portugal).
- **Central scenario**: our main scenario sees annual inflation reaching 2,2% in 2022 (1,3% in 2021), decelerating to 1,7% in 2023. **Risks are tilted to the upside**. Upward revision of our forecast very likely.

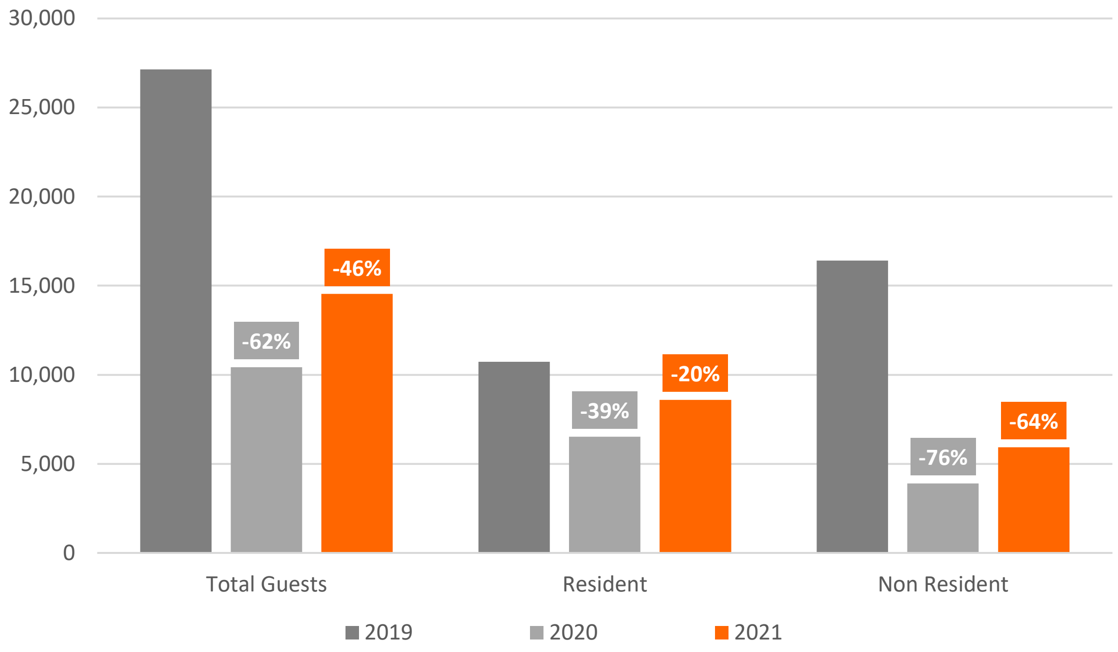
Tourism should recover as vaccines demonstrate their effectiveness

Number of flights, by quarter
Number



Source: *BPI Research, based on EUROCONTROL data.*

Number of guests (foreign and national)
Accumulated in the year (Thousand)

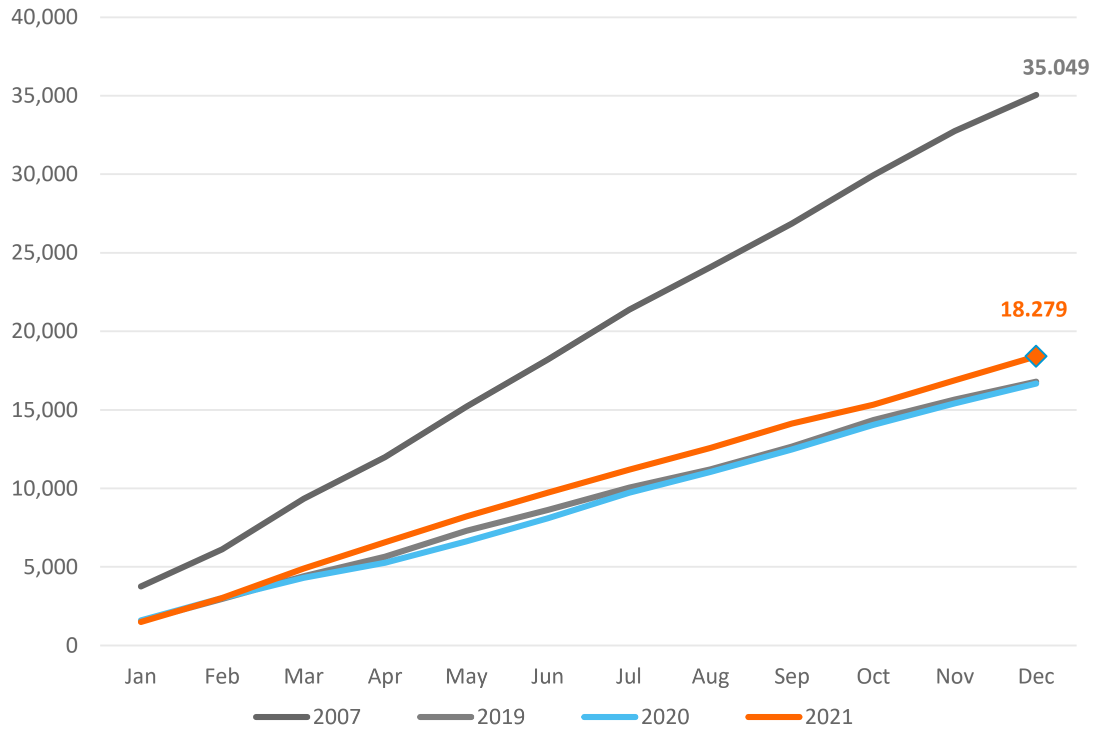


Source: *BPI Research, based on INE data.*

- **Tourism has been the sector hardest hit by the pandemic:** in 2021, the number of tourists reached 14.5 million, 39% more than in 2020, but still 46% below 2019. In the last months, the number of international tourists visiting Portugal has been increasing at a strong pace, but the total number of foreign guests is still 64% below the 2019 level. Domestic tourism (40% of total tourism demand in pre-covid era) remains 20% below the accumulated level of 2019.
- **Fundamentals remain strong and are complemented by the well succeeded vaccination process.** The Portuguese tourism industry is the 12th most competitive in the world and “safety & security” is viewed as one of its biggest assets. Hence, recovery should be supported by the successful vaccination process with circa 90% of the population already fully vaccinated and the effectiveness of vaccines to minimize the pressure on health sector. However, **the revival is subject to uncertainty** as confidence is one of the main constraints and also some headwinds can arise associated with a slower than expected recovery of the European airline business and the recent war in Ukraine.

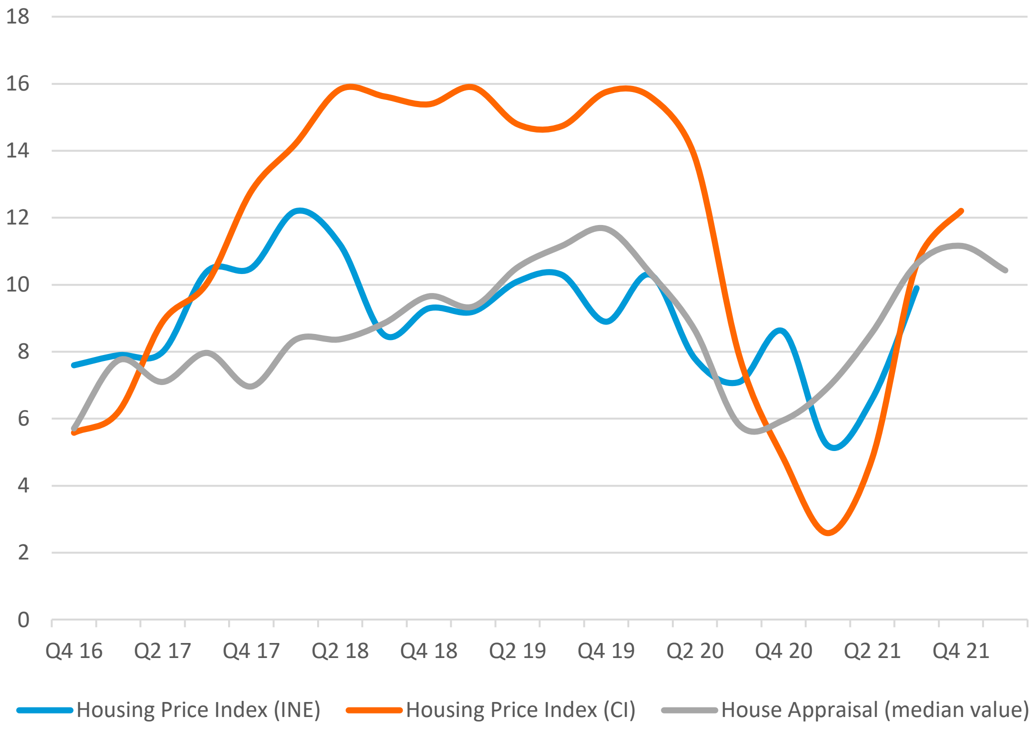
The real estate sector: resilience and solid fundamentals

Licenses to build new dwellings
Units accumulated in the year



***Source**: BPI Research, based on INE data.*

Housing prices
Year on year (%)

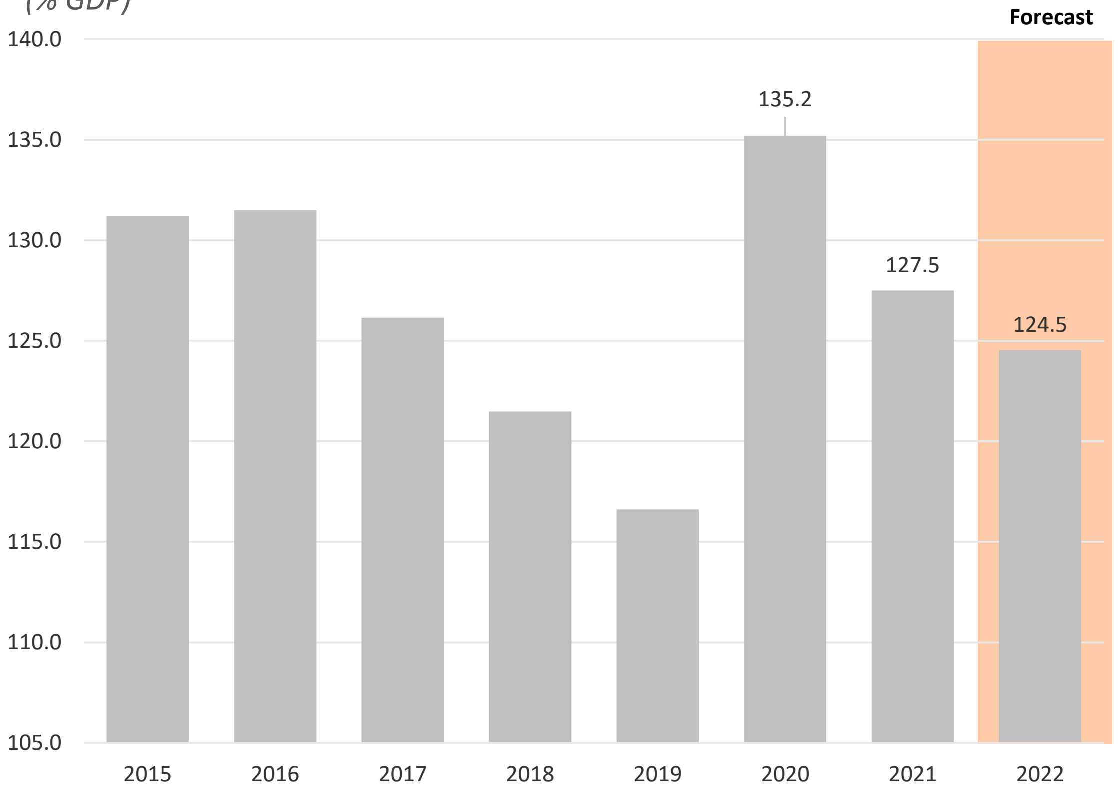


***Source**: BPI Research, based on INE and Confidencial Imobiliário data.*

- Both **new licenses and new construction are expanding, but they are still well below 2007 level**, suggesting a moderate pace of new homes entering the market, continuing to support prices. Additionally, prices continued to increase in last months of 2021 and confidence keeps strong in the sector.
- Going forward, **the market should continue resilient: no signals of oversupply, but the prices should decelerate in the coming years**, in line with the end of Vistos Gold in main cities as well as some cooling down expected from domestic buyers due to the end of some Covid-related supporting measures (namely moratoriums) and also due to the upward trend in interest rates. Housing prices may have increased 6,4% in 2021 and should decelerate to 4,0% in 2022, with upside risks to our scenario.

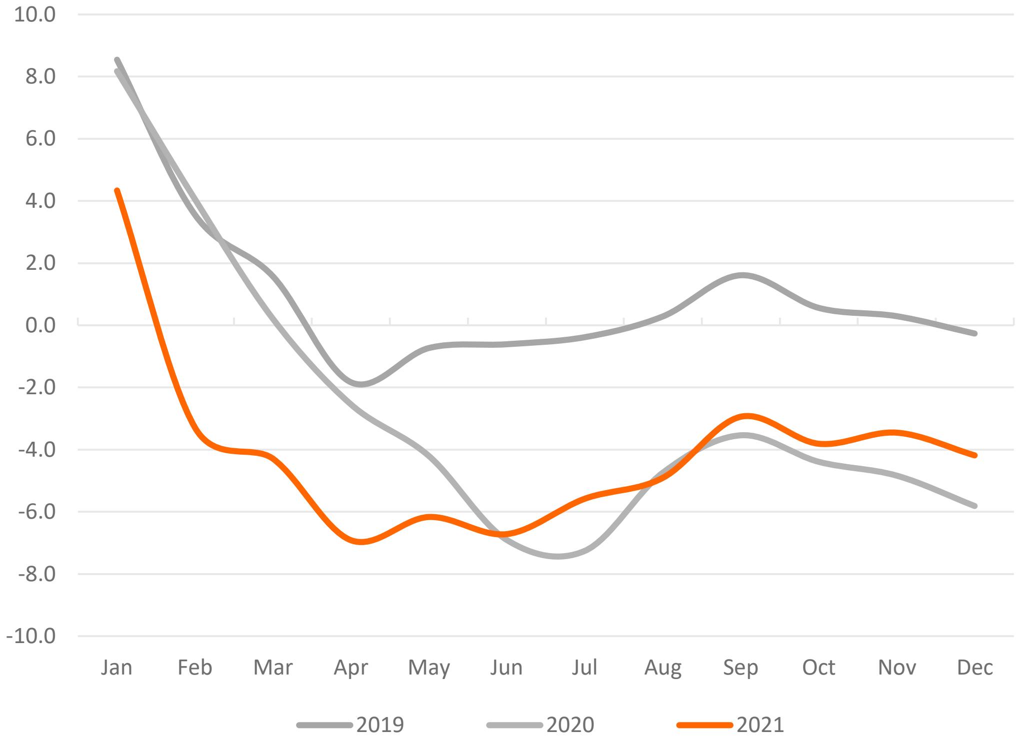
Fiscal deficit: positive surprise in 2021?

Public debt
(% GDP)



***Source**: BPI Research, based on Bank of Portugal.*

Overall fiscal balance of Public Administration*
(% GDP)

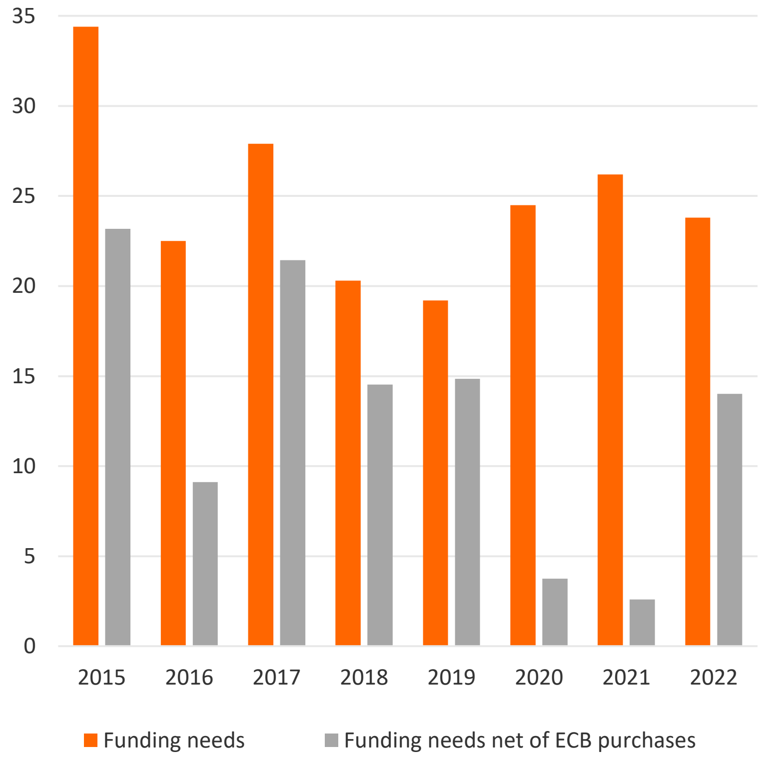


***Note (*)**: Budget execution according to the cash basis.*
***Source**: BPI Research based on DGO.*

- **Public debt (% of GDP) increased by 18,6 p.p. in 2020,** reflecting the supportive measures to companies, households and the health system due to the Covid-19 pandemic. Despite large, this increase was smaller than the evolution seen in other European countries (such as France, Spain, Italy), where supporting measures were larger. **In 2021, the public debt ratio decreased by 7,7 p.p. to 127,5% of GPD and should reach 2019 levels only in 2025** (Government's estimates)**. Going forward, keeping a sustained pace of economic growth, a moderate fiscal stance and low financing costs will be key for the achievement of these goals.**
- Probably, **the fiscal deficit in 2021 stood below the forecasts**; deficit may have stood below 4,0% of GDP, explained by the substantial increase in revenues (fiscal and contributory revenues, as well as Europeans funds).

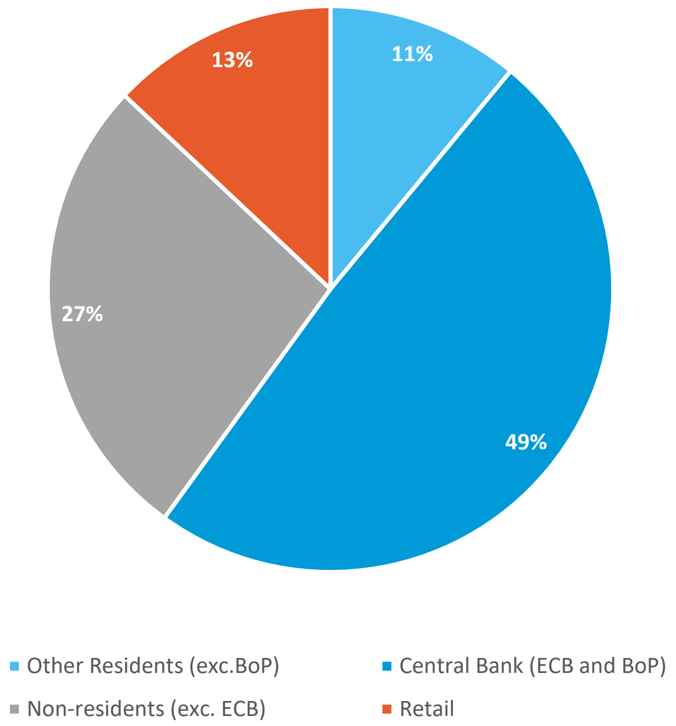
Funding needs are well covered

Portugal: Funding needs
(Billion euros)



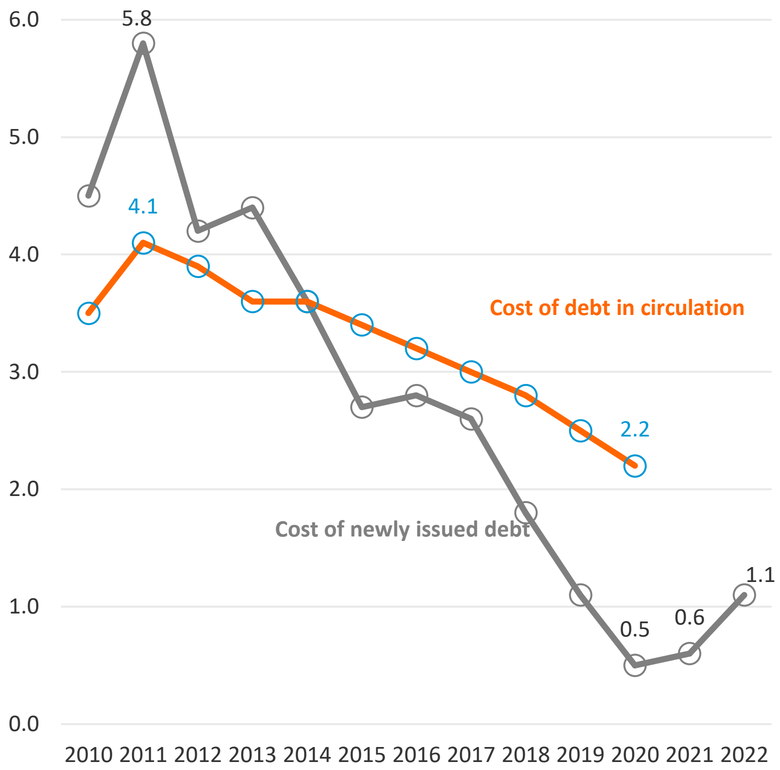
Source: *BPI Research, based on IGCP, BoP.*

Government debt by holders (exc. non-tradable debt)
(% of total; up to November)



Source: *BPI Research, based on IGCP.*

Cost of debt
(%)



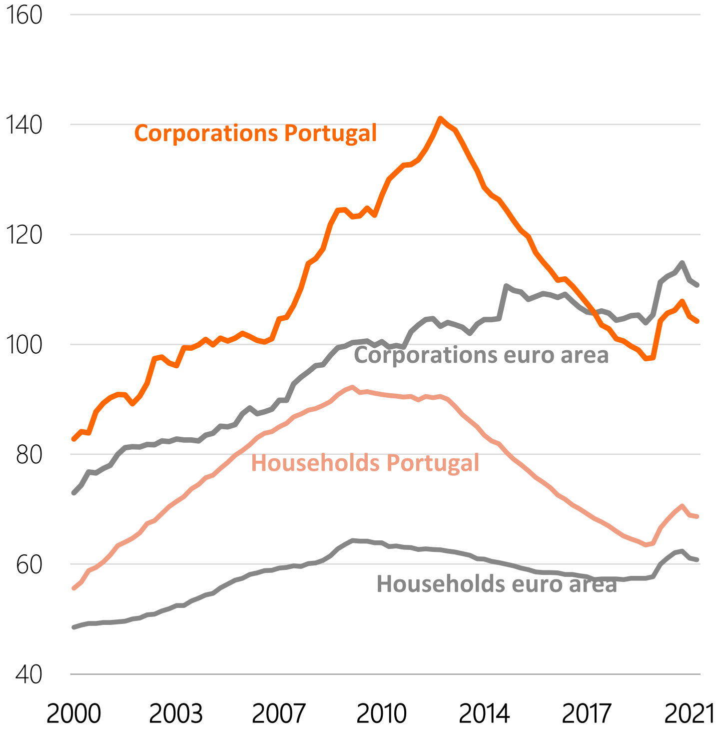
Source: *BPI Research, based on IGCP.*

- Funding needs not covered by the ECB in 2022 will be above those of 2020 and 2021, but still below the levels seen in 2018 and 2019.
- **However, public funding needs continue well covered, helped by ECB purchases** (expected to cover around 40% in 2022), plenty of liquidity available and low interest rates. 18% of total debt are EU loans linked to the Economic and Financial Assistance Program (PAEF). **Currently, the Treasury liquidity cushion amounts to €19 bln (≈9% of GDP).**

The Portuguese banking system: resilient and supporting the economy (1)

Gross private debt

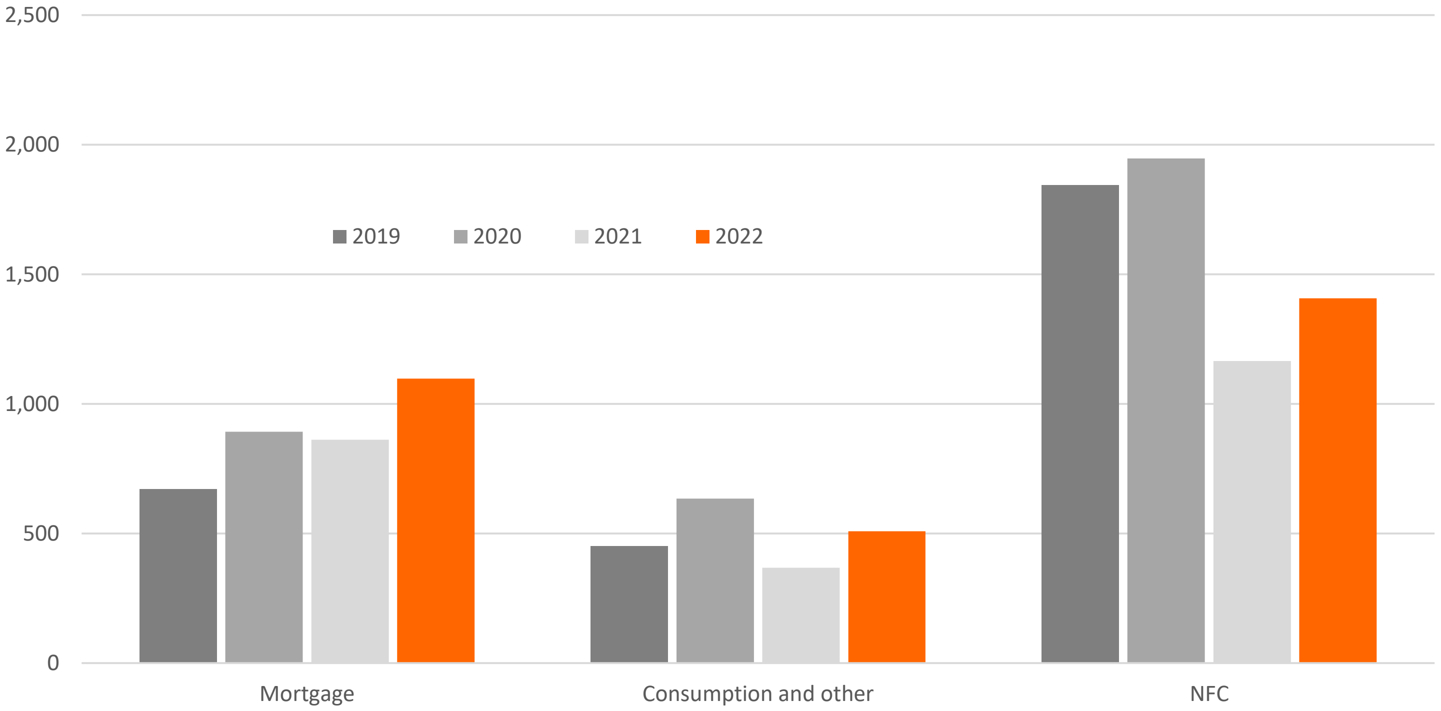
% of GDP, non consolidated debt.



Source: *BPI Research, based on Eurostat data.*

New lending activity in January by segments

(Million euros)



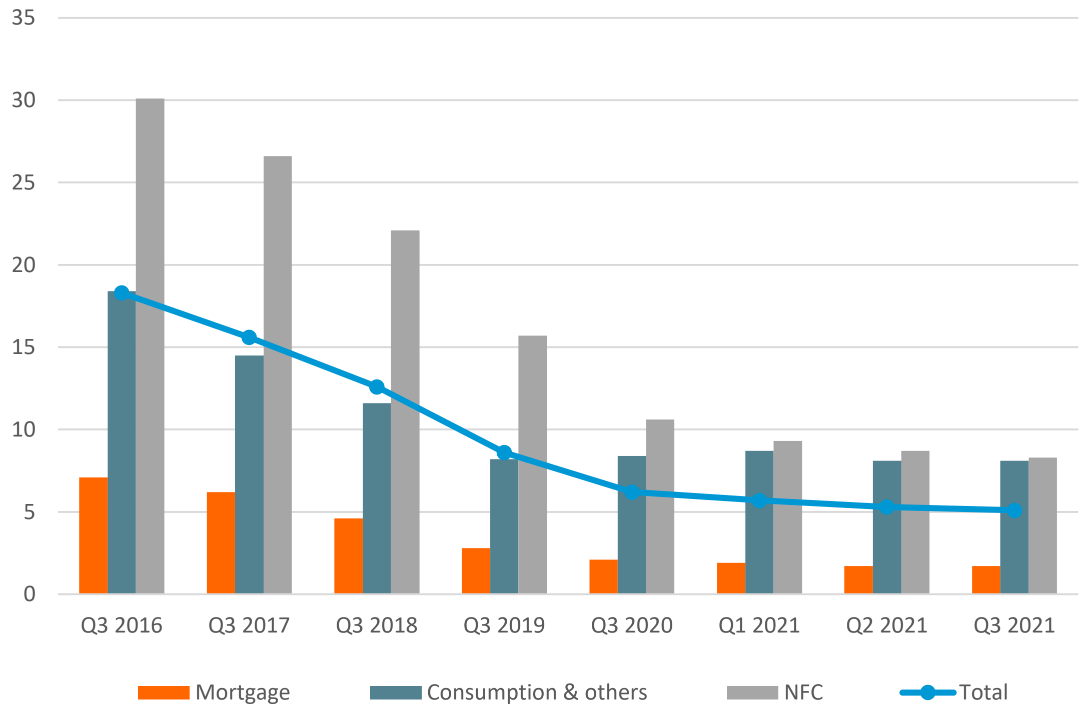
Note: *excluding renegotiations.*
Source: *BPI Research, based on BoP data.*

- **Corporate debt levels** remain below euro area average despite the recent pick-up in credit outstanding (mostly due to state guaranteed credit lines, issued back in 2020). **Household debt** has increased, reflecting expanding mortgage lending.
- **In 2021, new lending for the non-financial private sector contracted 11,4% yoy**, reflecting the fall of new credit to NFC (-33,5%). However, when excluding Covid-related credit lines, credit to companies decreased less (-9,9% yoy). **Data for households shows also a strong performance: new lending in 2021 increased 24,5%, due to the rise of 34% on mortgages**. The strength seen on the housing market, favorable financing conditions, the employment-supporting measures and the past households' balance-sheet improvements (deleveraging) explain this performance, although new mortgage credit (in volume) is still below the highs of the years 2006-07.

The Portuguese banking system: resilient and supporting the economy (2)

Non financial private sector: Non-performing loans

(%)



Private domestic credit

Year on year (%)

	Jan 2021 % yoy	Jan-2022 % yoy	2022 (For.) % yoy
Credit to the non-financial private sector	**4.5%**	**3.0%**	**3.4%**
Households	1.4%	3.2%	3.5%
Housing mortgages	2.2%	2.9%	3.3%
Other purposes	-1.3%	4.1%	4.1%
Consumer lending	-0.5%	2.5%	0.7%
Non-financial corporations	10.2%	2.6%	3.4%

***Source**: BPI Research, based on BoP data.*

- **Moratorium was an important supporting measure for both households and firms in the COVID context.** This measure was especially important to firms: **between August and October 2020, credit under moratorium reached a maximum of 34,1% of total credit for NFC. Moratorium ended at the end of 2021** for those who applied until March 2021.
- Considering the importance of this measure and the potentially negative impacts on the firms' solvency after its end, the Government decided to give a public guarantee (maximum of 25% of credit) directed towards the most affected sectors (with revenue drop of at least 15% in 2020 in comparison to 2019; firms that did not achieve the 2019 revenues level yet) and those who previously renegotiate with banks their credits (extending the grace period – without capital reimbursements - and enlarging the maturity). **Given the ample cushions in the banking system and the healthy balance sheet of households and companies compared with past situations, we don't expect a significant deterioration in NPL's due to the end of moratoria**.

Main economic forecasts

%, yoy	2013	2014	2015	2016	2017	2018	2019	2020	Forecasts 2021	Forecasts 2022
GDP	-0.9	0.8	1.8	2.0	3.5	2.8	2.7	-8.4	4.9	4.9
Private Consumption	-1.1	2.5	1.9	2.6	2.1	2.6	3.4	-7.3	4.5	4.1
Public Consumption	-2.0	-0.5	0.8	0.8	0.2	0.6	2.1	0.4	5.0	0.8
Gross Fixed Capital Formation (GFCF)	-4.9	5.0	6.5	2.5	11.9	7.9	3.2	-5.7	7.2	6.8
Exports	7.2	4.3	6.2	4.4	8.4	4.1	4.1	-18.6	13.0	17.0
Imports	4.7	8.1	8.1	5.0	8.1	5.0	4.9	-12.1	12.8	14.2
Unemployment rate	17.1	14.5	13.0	11.4	9.2	7.2	6.6	7.0	6.6	6.1
CPI (average)	0.3	-0.3	0.5	0.6	1.4	1.0	0.3	0.0	1.3	2.2
External current account balance (% GDP)	1.6	0.2	0.2	1.2	1.3	0.6	0.4	-1.2	-1.1	-1.0
General Government Balance (% GDP)	-5.1	-7.4	-4.4	-1.9	-3.0	-0.3	0.1	-5.8	-4.3	-2.9
General government debt (% GDP)	131.4	132.9	131.2	131.5	126.1	121.5	116.6	135.2	127.5	123.5
Risk premium (PT-Bund) (average)	464	252	189	307	269	138	98	89	60	68

Source: *BPI Research.*

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